

Page 1

1 UNITED STATES BANKRUPTCY COURT

2 SOUTHERN DISTRICT OF NEW YORK

3 Case No. 18-23538-rdd

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5 In the Matter of:

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7 SEARS HOLDINGS CORPORATION,

8

9 Debtor.

10 - - - - - x

11

12 United States Bankruptcy Court

13 300 Quarropas Street, Room 248

14 White Plains, NY 10601

15

16 December 14, 2018

17 10:07 AM

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21 B E F O R E :

22 HON ROBERT D. DRAIN

23 U.S. BANKRUPTCY JUDGE

24

25 ECRO: NAROTAM RAI

Page 2

1 HEARING re Notice of Hearing on Motion of Debtors for Entry
2 of an Order (I) Approving Debtors Incentive and Retention
3 Programs for Certain Key Employees and (II) Granting Related
4 Relief (related document(s)766)

5

6 HEARING re Motion of Debtors for Entry of an Order (I)
7 Approving Debtors' Incentive and Retention Programs for
8 Certain Key Employees and (II) Granting Related Relief
9 (document #766)

10

11 HEARING re Notice of Agenda of Matter Scheduled for Hearing
12 on December 14, 2018 at 10:00 a.m.

13

14 HEARING re Objection to Motion for Order Approving Debtors'
15 Incentive and Retention Programs for Certain Key Employees
16 and Granting Related Relief (related document(s)766) filed
17 by Paul Kenan Schwartzberg on behalf of United States
18 Trustee (document #1082).

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25 Transcribed by: Sonya Ledanski Hyde

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11 ALSO PRESENT TELEPHONICALLY:
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1 P R O C E E D I N G S

2 CLERK: All rise.

3 THE COURT: Please be seated. Okay, good morning.

4 Sears Holdings Corporation.

5 MR. DAHL: Good morning, Your Honor. Ryan Preston
6 Dahl of Weil, Gotshal, and Manges for the Debtors. With me
7 is Mr. Schrock (indiscernible) present motion before the
8 Court today.

9 THE COURT: Okay.

10 MR. DAHL: Your Honor, (indiscernible) the only
11 item on the agenda today is Docket Number 766 which is the
12 Debtors' motion (indiscernible) key employee incentive
13 (indiscernible). That motion is subject to a pending
14 objection by the United States Trustee filed at Docket
15 Number 1082 on December 7th. The Debtors filed a reply
16 together with additional venture support on December 12th at
17 Docket Number 1160.

18 Your Honor, I did want to thank the Court and your
19 staff for accommodating us at this time. We recognize this
20 is not the original hearing date set on this motion, but as
21 indicated in our reply and our papers, this is truly a
22 critical program for the company. Particularly, we are
23 already suffering attrition of key employees, having lost
24 one of our original key participants and five of our
25 original (indiscernible) motion (indiscernible).

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1 And in this regard (indiscernible) provide a brief
2 overview in terms of where we are with the U.S. Trustee and
3 other stakeholders, if that would please the Court.

4 THE COURT: Okay.

5 MR. DAHL: Your Honor, we did receive informal
6 comments from the Official Committee of Unsecured Creditors
7 respectively thrust upon this motion. We've addressed those
8 comments to modifications to the proposed (indiscernible) in
9 our reply revising order. We did file a revised order last
10 night and we'd please mark the Court of the changes
11 reflected in the order at the appropriate time.

12 THE COURT: Is that revised from what was attached
13 to the reply?

14 MR. DAHL: Yes, Your Honor.

15 THE COURT: Okay.

16 MR. DAHL: Adding additional clarification and
17 statements for the record in conjunction with the resolution
18 (indiscernible) Official Committee of Unsecured Creditors --

19 THE COURT: Okay.

20 MR. DAHL: That the Dahl statements in support of
21 (indiscernible). We have additional modifications
22 (indiscernible) reflected in the order filed last night
23 responding to (indiscernible) the lenders, resulting in
24 terms for its (indiscernible). With those modifications,
25 and other than the objection raised filed by the United

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1 States Trustee, we're not aware of any other formal or
2 informal objections or issues raised by any other party.

3 With respect to the objection filed by the United
4 States Trustee, we have tried very hard to resolve that
5 objection, including unilateral modifications for our
6 program, additional evidentiary submissions, (indiscernible)
7 production to the U.S. Trustee, and unfortunately, we have
8 not been successful in our efforts to narrow any of the
9 issues raised by the U.S. Trustee's objections. Thus being
10 the understanding that the U.S. Trustee will proceed with
11 the entirety of its objections.

12 As I said, we understand, too, that the U.S.
13 Trustee does not intend to prosecute and enter objection but
14 would not be objecting to the admission of the declarations
15 that were stated in evidence. And with that, Your Honor,
16 and subject to any questions of the Court, in terms of the
17 evidence here.

18 THE COURT: Okay. well, I -- first, I'd like you
19 to go through the changes that are made since the reply
20 brief.

21 MR. DAHL: Sure. (Indiscernible) the revised
22 formal order.

23 THE COURT: (Indiscernible) copy of that.

24 MR. SCHWARTZBERG: Your Honor, I apologize, Paul
25 Schwartzberg for the U.S. Trustee's Office. I can get a

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1 copy of that reply (indiscernible).

2 THE COURT: Sure.

3 MR. DAHL: May I approach, Your Honor?

4 THE COURT: Yes. Thanks. Is this marked to show
5 the changes from the last order?

6 MR. DAHL: Yes, Your Honor.

7 THE COURT: Is the -- at the back?

8 MR. DAHL: Correct, Your Honor.

9 THE COURT: Okay. Okay, (indiscernible) through.
10 I think I understand the basis for the changes. You can
11 (indiscernible) questions about the defined term,
12 discretionary award. (Indiscernible).

13 MR. DAHL: (Indiscernible) program took place, the
14 allegation of unused portions of the (indiscernible) pool be
15 allocated by the chief restricting officer in this provision
16 of our (indiscernible) committee on discretionary basis.

17 THE COURT: Okay. And that's the (indiscernible)
18 term?

19 MR. DAHL: Correct, Your Honor.

20 THE COURT: All right. Okay.

21 MR. DAHL: With respect to the changes generated,
22 Your Honor, the changes reflected at Page 3 (indiscernible)
23 clarifying in nature (indiscernible) changes (indiscernible)
24 substantive.

25 THE COURT: All right. Well, I mean, as I view

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1 this, the point of this is that the Committee and the U.S.
2 Trustee have a right to look at the amended budget insofar
3 as it is a starting point for the (indiscernible) measure
4 the award and the reference to effectiveness or establishing
5 really goes to whether that budget is an appropriate
6 starting point for the award, so that the award is still
7 based on difficult-to-achieve performance.

8 MR. DAHL: That's correct, Your Honor.

9 THE COURT: Okay. That's the Committee's and the
10 U.S. Trustee's understanding, too?

11 MS. BRAUNER: Correct, Your Honor.

12 THE COURT: All right. So it's a totally separate
13 analysis from determining the budget which is really a
14 separate process but it ties into the reality of the budget.

15 MR. DAHL: That's correct, Your Honor.

16 THE COURT: Okay. All right.

17 MR. DAHL: And --

18 THE COURT: The realistic nature of the budget.

19 MR. DAHL: Correct, Your Honor.

20 THE COURT: Okay.

21 MR. DAHL: And I don't want to balance the changes
22 (indiscernible) notice (indiscernible) to the Committee to
23 the United States Trustee both with respect to that
24 potential reset of the budget targets and also
25 (indiscernible) for example the addition or modification of

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1 the -- composition of the key participants (indiscernible).

2 THE COURT: And the financial parameters around
3 that as well as (indiscernible).

4 MR. DAHL: That's correct, Your Honor.

5 THE COURT: Okay.

6 MR. DAHL: So if any additional questions for the
7 Court (indiscernible).

8 THE COURT: Okay. I think I just have it -- does
9 this reflect the Committee's and the DIP Lender's
10 understanding with the Debtor?

11 MS. BRAUNER: For the record, Your Honor, Sarah
12 Brauner, Akin Gump on behalf of the Creditors' Committee,
13 and yes, as Mr. Dahl articulated, we had never
14 (indiscernible) formal concerns which had been discussed
15 over the past several days and weeks, and those are
16 reflected in the order, in the plan documents, and in the
17 reply and with those changes, the Committee feels
18 comfortable supporting (indiscernible) requests.

19 THE COURT: Okay.

20 MR. DAHL: (Indiscernible) counsel
21 (indiscernible). You can ask two additional additions
22 (indiscernible) DIP agent (indiscernible).

23 THE COURT: So where there's (indiscernible) the
24 Trustee is also the DIP agent?

25 MR. HOWARD: That's exactly right, Your Honor.

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1 George Howard from Skadden, Arps, the DIP agent and with
2 those changes (indiscernible).

3 THE COURT: Okay, very well. I have sort of
4 overriding question. I want to make sure there's no
5 confusion over. So before you get to the evidentiary
6 portion of the hearing, I just have these made clear. The -
7 - as I read it, the KEIP, K-E-I-P, has two three-month
8 periods. (Indiscernible) the budget and performance of the
9 budget starting at 10 percent over or not over. The motion
10 then describes a second component of the KEIP tied to the
11 acceleration events which are essentially transformative
12 transactions (indiscernible) business.

13 It's not clear to me how that ties into any award.
14 So can you lay that out just for the record?

15 MR. DAHL: Certainly, Your Honor. As Your Honor
16 noted, there are two components to the KEIP. Your first is
17 Q1 and Q2 there's a performance-based measure, as Your Honor
18 noted, by comparison to the operating cash in the budget.
19 In addition, in the event of a transformative redaction,
20 that would cause an acceleration. That is the operative term
21 that's been used. Which could accelerate the full balance of
22 the KEIP opportunity, just approximately \$8 million. So --

23 THE COURT: It truly is an acceleration event.

24 MR. DAHL: Correct, Your Honor.

25 THE COURT: So, for example, the thing that I

1 didn't quite understand, is it a 12-month period?

2 MR. DAHL: In terms of the entire pool, yes, it's
3 a 12-month period. Currently with two quarterly tests for -
4 -

5 THE COURT: For the KEIP, let me just make it
6 clear. One of the -- say one of the parties for the KEIP is
7 entitled to his or her award because they, as a group, met
8 the 10 percent target or more and they (indiscernible) leave
9 voluntarily so they were there for the six months. And then
10 they stay another three months and there's a Chapter 11 plan
11 confirmed in a month time. And let's just say they decide
12 to (indiscernible) or not do any work for those three
13 months. They don't get anything extra for those three
14 months, right?

15 MR. DAHL: It's -- when you say anything extra for
16 those --

17 THE COURT: They just get their regular salary or
18 (indiscernible) but they don't get any extra bonus because
19 it's just a six-month bonus period.

20 MR. DAHL: If they're there for a transformative
21 transaction, Your Honor, they would be entitled to the
22 (indiscernible) acceleration.

23 THE COURT: But that happens after the six months.

24 MR. DAHL: Correct.

25 THE COURT: So they've already earned their bonus

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1 for the six months. Do they get any bonus for the next
2 three months?

3 MR. DAHL: I understand, Your Honor. So
4 (indiscernible) third quarter in the Chapter 11 cases --

5 THE COURT: Right.

6 MR. DAHL: We would expect that we will
7 (indiscernible) in terms of (indiscernible) seeking approval
8 for an additional operating measure --

9 THE COURT: All right.

10 MR. DAHL: (Indiscernible).

11 THE COURT: That's an approved any such measure
12 and there's no way to get any bonus for that hypothetical
13 extra three months or extra six months?

14 MR. DAHL: Not with respect to operating funds,
15 Your Honor. In the hypothetical, if there is a
16 transformative transaction in nine months, is the case,
17 (indiscernible) acceleration (indiscernible).

18 THE COURT: But there's nothing to accelerate,
19 because I haven't approved it yet. I've only approved the
20 first six months.

21 MR. DAHL: As defined in the KEIP, for the Court,
22 you're defining an acceleration event that is this
23 transaction occurring within 12 months.

24 THE COURT: I understand, but I think it's a true
25 acceleration of something you've already earned. Since I

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1 haven't approved anything beyond six months, you're going to
2 come back to me after six months.

3 MR. DAHL: We will come back after six months --

4 THE COURT: All right.

5 MR. DAHL: -- with respect (indiscernible).

6 THE COURT: So you can set up this mechanism for
7 acceleration, but right now, I'm only approving --

8 MR. DAHL: I understand.

9 THE COURT: -- the acceleration if the
10 transformative acceleration that occurs within the first six
11 months.

12 MR. DAHL: Understood, Your Honor.

13 THE COURT: Okay.

14 MR. DAHL: -- make sure that that's
15 (indiscernible).

16 THE COURT: Just wanted to make sure, because, you
17 know, otherwise it would truly be just a save on this for
18 after six months.

19 MR. DAHL: We'll make sure that the acceleration
20 event will apply only in the six-month period.

21 THE COURT: You set up that structure so that you
22 are able to, with your consultants, with the independent
23 directors, with the Committee, the DIP Agent, agree on a
24 metric that's suitable for these cases if it's going to take
25 another six months. You've already set up that

1 acceleration.

2 MR. DAHL: That's correct.

3 THE COURT: Okay. All right. Just wanted to make
4 sure that was clear on that. Okay.

5 MR. SCHWARTZBERG: Your Honor, I apologize for --

6 THE COURT: Let me just -- state your name again.

7 MR. SCHWARTZBERG: Yeah, Paul Schwartzberg for the
8 U.S. Trustee's office. This is actually a transformative
9 conversation (indiscernible) intended on the work. My
10 understanding and the U.S. Trustee's understanding is that
11 we were in month seven, eight, or nine and there was an
12 acceleration event --

13 THE COURT: Right.

14 MR. SCHWARTZBERG: -- say a sale of all the assets
15 and we're a net cash flow of 104. We haven't reached 110.

16 THE COURT: Right.

17 MR. SCHWARTZBERG: They would get a bonus as if
18 they were up to 120 -- the 120 percent of cashflow. And my
19 understanding of what just went on -- and I could be wrong -
20 - is that that's not correct.

21 THE COURT: That's why I wanted to clarify. I
22 though there was some --

23 MR. SCHWARTZBERG: That was our -- that was a
24 primary objective with our --

25 MAN 1: Objection.

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1 MR. SCHWARTZBERG: -- objection of us -- of the
2 U.S. Trustee is that in months seven through 12, even if
3 they were below the 110 percent --

4 THE COURT: Right.

5 MR. SCHWARTZBERG: -- and there was, say, a sale
6 that didn't save one job, did not provide one penny to
7 unsecured creditors, there would still be a bonus. We
8 thought that was retentive in nature --

9 THE COURT: I wanted you to clear that up.

10 MR. SCHWARTZBERG: So it's my understanding --
11 once again, I apologize for being dense, Your Honor -- is
12 that that is now (indiscernible).

13 THE COURT: Okay.

14 MR. DAHL: And to be clear, we will make clear in
15 the order that acceleration event would trigger acceleration
16 provided that transformative transaction occurs in the first
17 six-month period in the case.

18 THE COURT: Okay, very well.

19 MR. DAHL: (Indiscernible).

20 THE COURT: Yes.

21 MR. DAHL: We submitted full declarations in
22 support of the (indiscernible), Your Honor. The first is a
23 declaration of (indiscernible) which is attached to our
24 motion as Exhibit B. Second is a declaration of Mr. Meghji,
25 the Debtors' CRO (indiscernible) Exhibit C. The

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1 supplemental declaration of Mr. Meghji attached to our reply
2 brief is Exhibit D and the declaration of Mr. Robert
3 (indiscernible), the Debtors' chief human resources officer
4 (indiscernible) Court today and be able to testify. We'd
5 ask that those declarations be admitted into evidence.

6 THE COURT: Okay. I've reviewed each of those
7 declarations. Does anyone want to cross examine any of the
8 declarants? Okay, I'll admit the declarations. I have a
9 couple questions that you may be able to answer. If not,
10 you can turn to one of the declarants who's best able to
11 answer that, but I've reviewed what she wrote.

12 MR. SCHWARTZBERG: Your Honor, for the record
13 (indiscernible) stipulates it be put on the record. We
14 weren't cross examining them, but the Debtor indicates
15 certain state certain facts.

16 THE COURT: Fine.

17 MR. DAHL: (Indiscernible) everyone stipulated
18 (indiscernible) with the U.S. Trustee.

19 THE COURT: Okay.

20 MR. DAHL: Namely, the core participants included
21 the following individuals. The Debtors' VP and head of
22 supply chain and has approximately 1,895 direct and indirect
23 reports. And additionally, the core participants include
24 the Debtors' VP, CFO, and COO of home improvement who has 14
25 direct reports and approximately 2,186 direct and indirect

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1 reports.

2 THE COURT: When you say "direct reports," you
3 mean to them or to --

4 MR. DAHL: Reporting directly to them. Yes, Your
5 Honor. The core participants also include (indiscernible)
6 Sears Logistics who has eight direct reports and
7 approximately 1,908 direct and indirect reports. The
8 Debtors' VP and general manager of the retail stores
9 (indiscernible) retail services who has eight direct reports
10 and approximately 10,576 direct and indirect reports.

11 THE COURT: Okay.

12 MR. DAHL: With that, Your Honor, that is the
13 evidence in support of (indiscernible) here today. Your
14 Honor, I won't belabor the argument (indiscernible) KEIP can
15 occur. As I noted, we have no objections other than the
16 objection raised by the Office of the United States Trustee
17 or another economic (indiscernible) Chapter 11 cases
18 (indiscernible).

19 The United States Trustee has (indiscernible)
20 those objections. With respect to the KEIP, we understand
21 the U.S. Trustee's objection (indiscernible) the
22 acceleration event (indiscernible) nature (indiscernible)
23 and the Debtors failure to establish the importance of the
24 key participants (indiscernible).

25 Additionally, Your Honor, the United States

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1 Trustee is objecting (indiscernible) budgets and therefore
2 adjust targets (indiscernible) no longer be incentivized to
3 require a performance. And the U.S. Trustee's object to the
4 basis that a KEIP is a (indiscernible) feature where a party
5 receives a bonus and then departs within a specified period
6 of time (indiscernible) paid those monies, those monies
7 should be subject to (indiscernible).

8 Your Honor, we think we could rest (indiscernible)
9 of the United States Trustee's issue (indiscernible) with
10 respect to our KEIP and the acceleration even is
11 (indiscernible) universe of the accelerating event
12 (indiscernible) in a six-month period at issue. With
13 respect to the important of key participants (indiscernible)
14 the United States Trustee has not objected to admission into
15 evidence the declarations (indiscernible) this November,
16 which we think established on an undisputed basis the
17 significance of these individuals (indiscernible) success
18 and incentives targeted by this program.

19 (Indiscernible) the Debtors' modified budgets, we
20 do not have the ability to modify budgets unilaterally with
21 respect to the program. In the event there is a
22 modification, (indiscernible) built in with respect to the
23 U.S. Trustee (indiscernible). And with respect to clawback,
24 there is an intended component to clawback under the KEIP
25 for (indiscernible) clearer (indiscernible). But we think

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1 the clawback program is very important to the company,
2 frankly, to make sure the individuals who receive bonuses
3 don't turn around and walk away without (indiscernible).

4 Your Honor, (indiscernible). We understand the
5 U.S. Trustee objects to the (indiscernible) primarily on the
6 basis of the Debtors' failure to (indiscernible) a burden to
7 establish (indiscernible) participants (indiscernible)
8 caselaw. Your Honor, again, we (indiscernible) the record
9 is clear that the (indiscernible) are not (indiscernible)
10 and may not be reasonable (indiscernible). None of our core
11 participants are Section 16 officers. None of our core
12 participants report directly or none of our core
13 participants participate in strategic planning or strategic
14 discussions or control the disposition of material assets
15 (indiscernible) Chapter 11 states.

16 They're senior vice presidents to keep
17 (indiscernible) which is the senior-most executive level in
18 the Debtors' organization. We do have three individuals
19 (indiscernible), but again, (indiscernible) the caselaw
20 (indiscernible) necessary to (indiscernible) insider in the
21 caselaw per extention.

22 As Your Honor may have been able to tell,
23 (indiscernible) facts. We knew with respect to Mr.
24 Schwartzberg and highlighted the fact that certain key
25 participants (indiscernible) a number of indirect reports,

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1 but Your Honor, there's no support in the caselaw. There's
2 a number of individuals (indiscernible) their status isn't
3 separate. As Your Honor knows, insider status is key to the
4 extent to which an individual's control over relation to
5 material (indiscernible) transactions should trigger an
6 increased level of scrutiny to those individuals.

7 And Your Honor, here, the notion that
8 (indiscernible) direct reports is not correlated to the
9 control that they may have such that (indiscernible)
10 warranted (indiscernible). Again, those individuals with a
11 number of direct reports do not, in our (indiscernible)
12 strategy, (indiscernible) reporting (indiscernible). So we
13 don't think it would be appropriate to use the extent to
14 which they have direct or indirect reports as a proxy for
15 their insider status.

16 We do think, Your Honor, (indiscernible)
17 instructed in terms of bifurcating the appropriate universe
18 of insiders (indiscernible) noninsiders. (Indiscernible)
19 dissension or (indiscernible) subsequent to the resignation
20 (indiscernible) key participants, that caused an increase in
21 responsibility for two individuals (indiscernible). As a
22 function of that increased responsibility, we determined it
23 would be appropriate for them to treat them as insiders
24 reflecting (indiscernible). So we think we made appropriate
25 modifications, recognizing the right standard in the law

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1 which is the sole control our individuals have such that
2 hold scrutiny of their insider status (indiscernible). Your
3 Honor, with that --

4 THE COURT: I'd like to explore the
5 (indiscernible) issue for --

6 MR. DAHL: Certainly, Your Honor.

7 THE COURT: There are multiple Debtors here and
8 you referenced (indiscernible) referenced board appointments
9 and (indiscernible) control over decision making for the
10 corporation. I'm assuming, but maybe I'm wrong, there are
11 multiple boards here -- are there, for these various
12 corporations?

13 MR. DAHL: They are different subsidiaries.

14 THE COURT: So, and just looking at the pleadings,
15 some of the people who fall into the curve are at a high
16 level in connection with either what seems to be a separate
17 corporation or a separate business segment, that it
18 (indiscernible) a lot of money on either one of those
19 (indiscernible) potential revenue. So my question is, when
20 you talk about decision making, are you just focusing on,
21 you know, the entire corporate enterprise or is it an
22 effective control by the holding companies who are over all
23 the other boards and decision making at subsidiaries levels?

24 MR. DAHL: With respect to decision making, Your
25 Honor, the relevant board is the Sears Holding

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1 (indiscernible) referring to in the papers, referring to the
2 board appointed (indiscernible) Sears Holding Corp. board
3 and even for subsidiary officers, ultimately, they're
4 reporting their responsibilities governed by (indiscernible)
5 and supervising the Sears Holding Corp. board.

6 THE COURT: So, you know, if you can't answer
7 this, maybe one of the declarants can. There's -- in is it
8 Weeber or Weber?

9 MR. DAHL: Weber.

10 THE COURT: Mr. Weber's declaration, supplemental
11 declaration. He describes in Paragraph 7, the job duties of
12 key participants, the key participants. And then in
13 Paragraph 13, he refers to three co-participants who were
14 appointed by the board and then he lays out the
15 (indiscernible) of those (indiscernible). And I don't think
16 those three really do have specific segment -- business
17 segment authority.

18 They're basically across the board that they're
19 sort of second tier professionals, assistant -- deputy
20 general counsel (indiscernible) tax which is a subsidiary of
21 the corporate counsel's office, (indiscernible) business
22 finance which is, you know, a junior position to the CFO.
23 So I was actually less concerned about them because they're
24 -- you know, hold the company level and accept the
25 declaration statement that they're under the control of

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1 their boss and can't do -- although they're important
2 people, they can't do the types of things that hit within
3 (indiscernible) status.

4 But I was more concerned whether they're --
5 whether some of the other KERP participants actually have
6 operation -- more than operational control over a stand-
7 alone corporation within the Debtors' corporate structure or
8 the abilities, if they could make wide-ranging decisions
9 over a major business segment or subsidiary. There's
10 probably a subsidiary (indiscernible) segment.

11 MR. DAHL: In answer to that, Your Honor,
12 (indiscernible) subsidiary entities, rather than the Sears
13 Corporate structure, the ultimate determinations to
14 unqualified (indiscernible) dictate the use of corporate
15 assets (indiscernible) the Sears Holding Corp. board.

16 THE COURT: All right. So the practices and
17 procedures in place so that if you want to, I don't know,
18 change your product line at a particular store or change the
19 insurance program, Sears insurance, you have to go to the
20 board to do that?

21 MR. DAHL: In terms of specific questions, Your
22 Honor --

23 THE COURT: I'm just going to use examples of the
24 out of the ordinary course at the subsidiary level, it might
25 not be at the corporate level. I just want to make sure

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1 that those people aren't -- at the subsidiary level some of
2 which they qualify submitting a Chapter 11 on their own, but
3 they're not -- they don't have that level of control over
4 that subsidiary.

5 MR. DAHL: Let me just clarify one point, if I
6 may.

7 THE COURT: Sure.

8 MR. DAHL: Thank you, Your Honor, (indiscernible),
9 just wanted to confirm, (indiscernible) restructuring
10 officer that was confirmed (indiscernible) management is
11 team is (indiscernible) is the key team for any decisions
12 (indiscernible) Your Honor suggested we go through, key
13 team, (indiscernible).

14 THE COURT: (indiscernible) if someone, let's say
15 a divisional vice president said from now on, we're going to
16 change our insurance program to be, you know, a material
17 change, whatever that would be.

18 MR. DAHL: Correct, Your Honor, that would go
19 through the (indiscernible).

20 THE COURT: Okay. Is that part of their job? I
21 mean, how is that described to them? How do they know that
22 they can't do those sorts of things?

23 MR. DAHL: The company has in place internal
24 protocols, and delegations of authority. And then there is
25 the operating practice, consistent with (indiscernible).

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1 THE COURT: All right. And then I wanted to turn
2 to the metric for the fee, for a second. I suppose I could
3 have done this (indiscernible) in my head, but under the
4 budget, let's assume for the moment that the company
5 outperforms the budget by 10 percent, so that the record
6 could be (indiscernible). Do we know what that aggregate
7 number would be? Just want to compare it to what the
8 aggregate payout would be.

9 MR. DAHL: Let me just double-check my math over
10 here. Okay, threshold performance, which would be the
11 aggregate payout.

12 THE COURT: Right.

13 MR. DAHL: That would be \$1.062 million across the
14 participants of the quarterly (indiscernible).

15 THE COURT: Right, but I'm saying, I want to
16 compare that to what the company gets from that 10 percent.
17 If you're 10 percent over budget, what's the increased cash
18 that comes in?

19 MR. DAHL: Well, the (indiscernible) measure, the
20 key performance is measured at (indiscernible).

21 THE COURT: Right.

22 MR. DAHL: I see, I would need to check the math
23 (indiscernible) on that and compare it to the 10 percent or
24 (indiscernible).

25 THE COURT: Right, I just want to -- to put it

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1 differently, if it's a relatively small percentage, then
2 it's a good deal. If it's 80 percent of the 10 percent that
3 the company's getting, then it's not that great of a deal.

4 MR. DAHL: Okay. Thank you for your patience,
5 Your Honor. Having a sidebar with more adept
6 mathematicians. At threshold performance, (indiscernible)
7 would need to outperform a \$6 million in order to trigger
8 that 1 million (indiscernible).

9 THE COURT: Okay, okay. And that ratio pretty
10 much continues up to the 20 percent?

11 MR. DAHL: It scales upwards, Your Honor.

12 THE COURT: Okay. And then in relation to the
13 KERP, is that -- the KERP, you fixed the metric, so the KERP
14 is included in the calculation, originally. But is it
15 budgeted for?

16 MR. DAHL: Yeah, the KERP
17 's in the budget.

18 THE COURT: Okay, roughly, a little under 17
19 million.

20 MR. DAHL: Yes, sir.

21 THE COURT: Okay, thank you. I'd like to hear
22 from the U.S. Trustee, (indiscernible).

23 MR. SCHWARTZBERG: Good morning, Your Honor.

24 THE COURT: Good morning.

25 MR. SCHWARTZBERG: Got two additional notes. One,

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1 in both -- Paul Schwartzberg for the U.S. Trustee, Your
2 Honor. In both the Debtor's reply, and in (indiscernible),
3 I just wanted to note that Debtor refers to the fact that
4 the U.S. Trustee is the only party that is objecting, or
5 filed an actual objection, and we have no (indiscernible) a
6 financial stake in the Debtor.

7 And I just want to point out, I'm sure Your Honor
8 is aware, that's not the basis for the motion, regardless of
9 who objects, the Debtor still needs to comply with the
10 Bankruptcy Code. Second, Your Honor, the primary focus of
11 our objection, or our presentation today was going to be on
12 the acceleration event, on 6 through 12. So now that that
13 is off the table --

14 THE COURT: We've given that up.

15 MR. SCHWARTZBERG: I appreciate Your Honor's
16 comments on that. The one concern we still have with the
17 acceleration event is that if you're within anything six
18 months, and they are below the 110 percent, as I read the
19 document, although it might have changed now.

20 But as I read it, if they are say, 99 percent over
21 budget, and there is an acceleration event within that first
22 six months, the acceleration event still will allow the
23 participants to receive the bonus as if they were at 120
24 percent. So --

25 THE COURT: Is that right? I didn't think that

1 was right.

2 MR. DAHL: Yes, that's correct, Your Honor.

3 MR. SCHWARTZBERG: So we still had --

4 THE COURT: I thought they had to be, at least for
5 that period, within the metric.

6 MR. DAHL: In an acceleration event, the full
7 balance will accelerate.

8 THE COURT: But only if they're earning it.

9 MR. DAHL: We will rise to make clear that the
10 acceleration event will be subject to falling within the
11 parameters of the (indiscernible).

12 THE COURT: So just to be clear, that let's say
13 the plans is confirmed within four months, or there's a sale
14 of substantially all the assets within four months, any time
15 before six months. If in those four months, the metric has
16 been met, which is four months, that is the first quarter
17 over the ten percent, first month of the second quarter is
18 over ten percent, then it's a summary. But if for the first
19 month of the second quarter, it's not over 10 percent, it's
20 say, four percent, I didn't think it would be accelerating,
21 since they haven't in essence made their target.

22 MR. DAHL: Two clarifications, Your Honor. If the
23 accelerating event occurs in the second quarter --

24 THE COURT: Yeah.

25 MR. DAHL: The accelerated balance will not

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1 include the first quarter. Acceleration of a mechanism only
2 applies to remaining quarters.

3 THE COURT: I understand, but if you're in that
4 second quarter, and the metric is actually lower, it seems
5 to me that that's a problem.

6 MR. DAHL: We will make it clear that the
7 acceleration event will be tied to --

8 THE COURT: Be in compliance in that time.

9 MR. DAHL: At least threshold performance.

10 THE COURT: Every time, which is the 10 percent.

11 MR. DAHL: Yes, Your Honor.

12 THE COURT: All right. Because otherwise, I think
13 it would have fallen afoul of the statute, and the case law
14 by (indiscernible) --

15 MR. SCHWARTZBERG: So just as I've indicated, Your
16 Honor, stated on the record again, they need it make the 110
17 percent for (indiscernible) --

18 THE COURT: Well, with one caveat, which is that
19 again, if the acceleration event occurs in the middle of
20 that second quarter, they only have to make the 10 percent
21 up to the point --

22 MR. SCHWARTZBERG: Yes, exactly. And then they
23 get an acceleration of that quarter, but if we're at 94
24 percent, 103 percent, acceleration event doesn't trigger the
25 bonus.

1 THE COURT: Correct. And the rationale for that
2 is I appreciate that they are working hard, and getting the
3 case over with, but at that point, it really does look like
4 they're just getting paid to be there, because part of the
5 job is to work hard. On the other hand, I have no problem
6 with the acceleration, because there's real benefit to the
7 company in having the transformative event early. And that
8 transformative event probably will be more favorable to the
9 company if it is exceeding expectations. So I don't have
10 any problem with tying to the two together that way, as was
11 the case, I think, in Borders, for example.

12 MR. SCHWARTZBERG: Your Honor, with those changes,
13 I would just turn to (indiscernible).

14 THE COURT: Okay.

15 MR. SCHWARTZBERG: I know Your Honor's already
16 exploring this issue, but for the record, Your Honor, I
17 think there's a fundamental difference between, I guess what
18 the Debtors believe, and the U.S. Trustee believes an
19 insider is defined as. In Weber declaration,
20 (indiscernible) indicate there needs -- the company must
21 have -- an insider must have a company (indiscernible),
22 whereas the U.S. Trustee is relying on the (indiscernible)
23 case, that indicates that a person with (indiscernible)
24 responsibility overseeing an aspect of the debt can be an
25 insider. So it's a segment that can be a \$400 million

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1 segment, but not the entire case. It's (indiscernible) in
2 charge of that, then the U.S. Trustee (indiscernible) --

3 THE COURT: Well, it depends on whether they
4 charge (indiscernible), and that's why I went to through the
5 discussions with Debtor's counsel. You can have significant
6 operational responsibility for a big enterprise, and still
7 be a junior executive, in essence. And you may be very
8 well-compensated for what you do, for a big enterprise.

9 But if you can't make the transformative decisions
10 for that -- (indiscernible) words here, you can't make the
11 big decisions for that enterprise, and I don't think that
12 you would fit within the definition, at least it's I think
13 very well-articulated by Judge Glenn in the Borders case, up
14 to an officer, as defined by Black's and the corporate case
15 law. You're important to the enterprise, but you don't have
16 the ability to (indiscernible), or to cause your friends at
17 the corporation (indiscernible). And I think that's what
18 503(c) (indiscernible).

19 MR. SCHWARTZBERG: Just for the record, Your
20 Honor, the U.S. Trustees believe the case, the current
21 participants that were appointed, the ones that have titles
22 of CFO or COO, and the ones that have thousand or more
23 reports, including the ones we previously discussed, on I
24 think it was Paragraph 13 in the Weber declaration. In
25 fact, one of them that he attacks and identifies why that

1 (indiscernible), why tax policy and strategy, Mr.
2 (indiscernible), those are (indiscernible) case. I wanted
3 to put that on the record, Your Honor.

4 That argument, with the changes of regarding the
5 acceleration (indiscernible) are to-- the change in the
6 acceleration (indiscernible) satisfies us with
7 (indiscernible), but I just want it on the record that the
8 UST believe that those participants are clearly insiders.

9 THE COURT: Well, I mean, I do see your point on
10 the tax person. As described, but I'll contrast it to the
11 manager of business finance, and the deputy general counsel,
12 which are also described in Paragraph 13 of Mr. Weber's
13 declaration. The manager of business finance basically
14 interacts with everyone else under the control of the CFO,
15 and other people. He's a facilitator, in essence, or she.

16 And the deputy general counsel does important
17 things, including he or she is involved in negotiations, and
18 implementing providing legal support, et cetera. But again,
19 it doesn't seem to me that person has material decision-
20 making authority. The EVP tax, or the (indiscernible) tax
21 is described as "has overall responsibility for all aspects
22 of tax and of leadership for tax organization, leads the
23 design and implementation of enterprise-wide tax policy and
24 strategies." So basically, you look at that, it suggests
25 that that person can decide whether we're going to switch to

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1 a particular entity, to being a different corporate form,
2 for example, which is really important. So maybe I should
3 hear a little more about that person.

4 And I'll note that one of the key decisions in a
5 Chapter 11 case like this is tax-related, the Debtor's tax
6 attributes are, at least as set forth in one of the first-
7 day motions, potentially extremely valuable. So if that
8 person really is in charge of (indiscernible) Delaware,
9 subject to board approval, which everyone else is subject to
10 board approval, and (indiscernible) then that person
11 (indiscernible).

12 Well, generally, if I'm reporting to the board, or
13 being employed by the board, Judge Glenn discusses this in
14 Borders. Page 468, he says the term officer is likewise not
15 defined by the Code, however Courts have looked to Black's
16 Law Dictionary as a source of authority. According to
17 Black's, an officer is defined as "a person elected or
18 appointed by the Board of Directors to manage the daily
19 operations of a corporation, such as a (indiscernible)
20 secretary or treasurer."

21 The Court have also noticed a (indiscernible)
22 corporate law, including Delaware Code for judicial
23 guidance. For example, (indiscernible) case could examine
24 the different laws, both state and federal, and concluded
25 that "board appointment or election is frequently identified

1 as distinguishing officer positions from other type of
2 positions within a corporation," and then "if the
3 (indiscernible) is present, the title of the position
4 ordinarily is an officer position as a matter of law?" And
5 (indiscernible) require the additional elements on decision
6 (indiscernible).

7 So this person is appointed by the board, it seems
8 they put the notice more on the company to explain why he or
9 she is an insider. And (indiscernible) just two levels down
10 from the board, so maybe they should be (indiscernible) to
11 occur. The other two are also appointed by the board, but
12 to me, they were (indiscernible) report, not the
13 (indiscernible) quibble of assistant secretary, and
14 (indiscernible). So I think you may be right about the task
15 person, unless that declaration really is not -- should be
16 qualified somehow.

17 MR. DAHL: With respect to our vice president of
18 tax, maybe it's (indiscernible), which is that in terms of
19 the responsibilities delegated to the VP of Tax, the VP does
20 not have an independent decision-making for (indiscernible),
21 in the hypothetical Your Honor did, changing the order form,
22 the documentation --

23 THE COURT: Well, it kind of looks like that's who
24 they are. If they decided tax policy, effectively they're
25 changing the form.

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1 MR. DAHL: Tax policy recommendations for this
2 individual will be made to the chief financial officer, and
3 ultimately office of the chief executive, and then the
4 board. Certainly there's a statutory --

5 THE COURT: So nobody had the authority to set tax
6 policy?

7 MR. DAHL: Unilaterally, without reporting to the
8 CFO, or the office of the chief executive?

9 THE COURT: Right.

10 MR. DAHL: No, Your Honor.

11 THE COURT: Okay, okay.

12 MR. DAHL: So they are responsible for execution
13 and making recommendations, but those recommendations are
14 made to the CFO or the Office of the Chief Executive,
15 (indiscernible).

16 THE COURT: Okay. Do you want to cross-examine on
17 that point, or are you willing to accept that clarification
18 of the declaration, Mr. Schwartzberg?

19 MR. SCHWARTZBERG: Your Honor, I have no reason to
20 believe that what they're saying is inaccurate.

21 THE COURT: All right. Okay, well based on that
22 clarification, I would say that they're not (indiscernible).

23 MR. SCHWARTZBERG: Thank you, Your Honor.

24 THE COURT: Okay. It's somewhat ironic that the
25 larger a corporation is, the more responsibility you have

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1 without qualifying as an officer, but actually, that kind of
2 makes sense. Unless it's a decentralized corporation, which
3 maybe business schools will look back on this and say it
4 should have been.

5 Okay, I did not get, in looking at the U.S.
6 Trustee's objection, or the oral argument, I did not get the
7 impression that the U.S. Trustee felt that as a business
8 judgment matter, if he was, in light of the changes that
9 we've discussed, or the clarifications that we've discussed
10 on the record. Similarly, I did not view the U.S. Trustee's
11 objections, say that the KERP was, as a business judgment
12 matter, inappropriate. Rather, that objection went to who
13 should be given that KERP.

14 And I think this is probably where the relevance
15 of no party with a financial stake in the case objecting is
16 relevant. The business judgment standard by which an
17 appropriate key, in appropriate and a KERP should be
18 evaluated, as is clear in the case law, is essentially the
19 business judgment standard employed by Bankruptcy Courts in
20 the (indiscernible) transactions that (indiscernible)
21 Subsection 363(b) under the (indiscernible) facts and
22 circumstances.

23 And I need to be clear, when I say what I mean by
24 that. I don't believe that is the corporate business law,
25 business judgment standard. I think ultimately, that

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1 (indiscernible) interest case. Ultimately, the bankruptcy
2 judge has to apply his or her own sense of whether the
3 decision is in good exercise of business judgment, informed
4 by all the facts and circumstances as laid out on the
5 record. However, as is the case here, there are multiple
6 parties who are themselves sophisticated, and they're
7 represented by sophisticated counsel, who have substantial
8 financial stake in the case, as well as Debtors who are
9 advised by experts such as (indiscernible).

10 The Court will be taking very little comfort in
11 the lack of their objection, or in the case of Mr. Weber
12 (indiscernible), the support of the plan decision. So I
13 conclude that the KERP does satisfy the business judgment
14 standard. I also believe that taking into account the clear
15 admonition in the case law is more or less the purpose of
16 Section 503(c)(1), which as we clearly see in the case law
17 (indiscernible) Congress enacted the statute as part of the
18 2005 BAPCPA amendments to "eradicate the notion that
19 executives were entitled to bonuses simply for staying with
20 the company through the bankruptcy process." And that in
21 light of that concern, "courts must be wary of attempts to
22 characterize what is essentially an insider retention plan
23 as an incentive plan to bypass the requirements Section of
24 503(c)(1). We should consider the circumstances under which
25 particular proposals are made, along with the structure of

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1 the compensation packages, when determining whether the
2 compensations programs are subject to Section 503(c)(1)."

3 And then further quoting, "The court must examine
4 the proposed KERP mindful of the practice that Congress
5 sought to eradicate and, at the risk of oversimplification,
6 determine whether the proposed targets are designed to
7 motivate insiders to rise to the challenge, or incentive
8 merely to report to work."

9 Those are all from In re Hawker Beechcraft, Inc.,
10 479 B.R. 308, 313 (Bankr. S.D.N.Y. 2012) and the authorities
11 cited in (indiscernible). And I've reviewed the KEIP in
12 that light and I started to find on the record today, and
13 it's also clarified and resolved before then, even with
14 informal objections by the Creditors' Committee. I believe
15 that the KEIP is primarily incentivizing (indiscernible)
16 clearly intended. And that the finding here, in light of
17 the Debtors' business, is a reasonable one. It is not a
18 layout for (indiscernible) will be important to reach.

19 I also believe that with a business of this size,
20 as was set forth in the declarations, it's unreasonable to
21 expect that you would have specific individual targets for
22 these people (indiscernible) sports analogy.

23 As recognized by, actually, Judge Bernstein in the
24 Hawker Beechcraft case where he refers to (indiscernible) or
25 as part of the team (indiscernible) as far as the measure of

1 the general counsel's performance by (indiscernible)
2 specific measure (indiscernible) overall that
3 (indiscernible). But obviously, general counsel
4 (indiscernible) Chapter 11 (indiscernible) particularly
5 (indiscernible) to that success when it occurs.

6 So, I believe that, again, turning to the second
7 element, or the second (indiscernible) analysis for the
8 KEIP, it does satisfy the standard of 503(c)(3) as
9 determined by the courts in the circuit to make business
10 (indiscernible).

11 The only remaining objection, then, is whether
12 there are certain members of the group that would be covered
13 by the proposed KERP plan that really should not be limited
14 because they modified (indiscernible) put aside, which
15 includes officers. And at one level, since these people --
16 at least many of them have titles like vice president,
17 manager, director -- not board director -- but director of a
18 firm, something.

19 They are (indiscernible) to be defined as an
20 officer. But as the case law makes clear, particularly for
21 a different case that I previously quoted, which appears at
22 453 B.R. 459, you can be a (indiscernible) or a first
23 lieutenant and not be an officer for purposes of Section
24 503(c)(1).

25 So, the question is applying the Congressional

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1 purpose and the general designation of officer in the legal
2 context for a corporation, are any of these people
3 "officers" for purposes of 503(c)(1) therefore not qualified
4 to be in the KERP.

5 For most of the over 300 individuals proposed to
6 be covered by the KERP, that's really not an issue. There
7 are a handful of people who under the facts and
8 circumstances analysis may -- question (indiscernible).
9 Particularly the three who are quoted by the board. But
10 based on the record before me, including the representations
11 made at the hearing as to their job responsibilities
12 (indiscernible) indications of the decision-making
13 authority. And consequently, in their -- the likelihood
14 that they would not be able to (indiscernible) or
15 collectively with the other decision-makers (indiscernible)
16 favor themselves at the expense of other employees or
17 creditors, I conclude that they are not insiders for
18 purposes of Section 503(c)(1).

19 I took a look again at U.S. Bank National
20 Association (indiscernible) LLC, 138 Supreme Court
21 (indiscernible) 2018 to make sure that (indiscernible) court
22 hadn't changed anything in the law on this issue of where
23 there's an insider. But based on my review of that case,
24 which only stands for the proposition as a legal matter,
25 that a determination by the Bankruptcy Court of insider

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1 status is primarily factual and therefore subject to
2 (indiscernible) review standard as opposed to a lesser
3 standard.

4 I don't think this (indiscernible) standard before
5 us to the case law (indiscernible) judges have referred to
6 over the years. And that is well summarized in the Borders
7 case on this.

8 So, the only thing I would say is that at least
9 based on the concurring opinions of four other justices in
10 that case, the standard for deciding an insider is still
11 somewhat open, at least a non-statutory insider would be
12 very context-specific. So that they will be, for example,
13 an insider for (indiscernible) 29(a)(10) purposes is
14 different than 503(c)(1) purposes.

15 But again, based on the record before me, I don't
16 believe that the Congressional purpose would be served by
17 pre-designating any of the people who are currently
18 (indiscernible) eligible for the KERP and its insiders.

19 So, I'll grant the motion, as modified, including
20 the (indiscernible).

21 MAN 1: Thank you, Your Honor.

22 MAN 2: Thank you, Your Honor. I apologize. Just
23 because of the changes specifically regarding the
24 acceleration, then, I would just ask counsel to circulate a
25 --

1 THE COURT: Yes. So, the order should be
2 circulated to the counsel's, the Committee, the DIP lenders,
3 and the U.S. Trustee.

4 MAN 2: Absolutely, Your Honor.

5 THE COURT: But in the meantime, I think people
6 can rely on the (indiscernible) today (indiscernible).

7 Okay. Thank you.

8 MAN 2: Thank you.

9 THE COURT: I had actually had (indiscernible), so
10 I'm not going to (indiscernible). And those of you who are
11 on the call, unless you're here for In re (indiscernible)
12 7th Avenue (indiscernible) case, you can ring off.

13 (Whereupon these proceedings were concluded at
14 11:12 AM)

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1 C E R T I F I C A T I O N

2

3 I, Sonya Ledanski Hyde, certified that the foregoing
4 transcript is a true and accurate record of the proceedings.

5

Sonya
Ledanski Hyde

Digital signature of Sonya Ledanski
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25 Date: December 20, 2018

[& - analysis]

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